WHITEPAPER

Opportunities in Private Credit: Look Before You Launch

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The last decade has seen a massive increase in private credit funds in both the US and Europe. Although smaller than other private market categories in absolute terms, the growth of private credit (a/k/a private debt) has significantly outpaced that of private equity, venture capital and real estate funds, posting an annual average rate of 13.5% for the past 10 years, according to alternatives analyst Preqin. Investments in private debt hit a record US$193.4 billion in 2021, up 14% from the previous year. As of year-end 2021, the market reached an estimated $1.21 trillion in assets under management globally. Preqin expects that number to climb to $2.69 trillion by 2026, and that private debt AUM will exceed that of real estate funds by the end 0f 2023.[1]

The US and Europe combined comprise around 95% of the global private debt deal market. While investor appetite is reportedly strong in the Asia-Pacific region, the market is still considered in its nascent stage. Private debt fundraising in Asia reached $8.5 billion in 2021, compared with $114 billion for North America and $66 billion for Europe.[2]

The reasons for the market's past and projected growth are fairly straightforward: the concept of private lending via funds appeals to investors and borrowers alike. For borrowers, who tend to be privately held small- and medium-sized enterprises, private credit offers a more flexible alternative to bank lending, with the opportunity to negotiate terms and the likelihood of faster funding. For investors, private debt funds represent a source of steady, stable returns at attractive, risk-adjusted rates, even during volatile times. The market has been bolstered by an influx of institutional capital, most notably from pension funds seeking good quality issues at relatively low risk to their stakeholders. Some 91% of investors surveyed by Preqin said they intend to maintain or increase their allocations to private debt over the long term.

Layers of Operational Complexity

Because of the category's growth and its appeal to institutional allocators, many managers from the private equity and hedge fund realms are eager to break into the market. However, fund firms face a number of challenges. For the same reasons that private debt has become popular, it has also become extremely competitive, both in deal sourcing and in fundraising, and dominated by well-established players. New entrants will have to have a clearly differentiated proposition in order to attract investor attention.

Start-ups also face a steep climb from an operational perspective. Where a typical private equity portfolio might have 10 to 12 investments in it, loans in a single credit fund can number in the hundreds. Besides requiring specialized expertise and knowledge, managers need to rethink their infrastructure. Systems designed to support private equity or even real estate funds are likely not readily adaptable to the volume, complexity and multiple moving parts associated with private debt funds.

Moreover, private company loan data does not lend itself easily to automation. Company information comes in a variety of forms, with little standardization, resulting in a high degree of paper-based and manual processing. Cash flows, too, can be sporadic and unpredictable, with variable interest rates on multiple loans, different payment schedules and occasional delinquencies.

What You Need

Before going live or trying to line up investors, it's essential to have a strong operational infrastructure in place to support the business. Fund managers need capabilities to handle three aspects of private debt operations:

- Loan servicing and administration: the ability to collect payments and allocate returns among limited partners efficiently and accurately
- A portfolio accounting solution that can handle a high volume of transactions
- Efficient support for different fund structures; credit funds are typically closed end, but some may be hybrids and/or may include multiple special purpose vehicles (SPVs)

The European market adds a layer of complexity with investments across borders. Unlike US funds, which tend to be concentrated in the North America market, European portfolios can have broad geographic mix across the continent. Fund managers need to be aware of the compliance requirements of the various jurisdictions in which their loans originate, as well as being able to account for each fund entity's investments in multiple markets and currencies.

Treasury management takes on added importance, too. With a wide range of deals and continual cash movement, funds need to stay on top of their foreign exchange exposure, as well as opportunities to apply returns from their investments against proceeds recycling provisions or leveraged positions they may have.

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Take Advantage of Experience

Understanding the stark differences between running a private credit fund and other alternative asset classes, you may think you are looking at a substantial investment in technology and operational expertise in order to be competitive from day one. There is a more expedient and less expensive route, however: partnering with a proven technology and services provider that already has the infrastructure and expertise in place to support private debt funds globally, including solutions for loan servicing and administration, portfolio accounting, and managing a variety of fund types and structures. If you are looking to diversify an existing private equity or hedge fund business, the optimal scenario would be to work with a provider with experience and resources across the alternative fund landscape. You should also be looking for experience with the regulatory, accounting and tax requirements in all the jurisdictions in which you are likely to invest. A provider that can help you manage all the operational issues you face, as well as having universal bank access through a single portal, presents distinct advantages.

Trusting your technology and operations needs to experts will accelerate your time to market and increase the likelihood of success, allowing you to focus on sourcing deals and raising capital. The right provider can also help in winning investors with a robust platform that stands up to the most rigorous operational due diligence. When you have the right underpinnings in place, the challenges look far less daunting and the opportunities more abundant.

About SS&C Private Markets

SS&C Private Markets Group enables its clients to modernize and create efficiencies across investment operations, combining expertise, technology, and integrated data strategies to support highly diversified portfolios and complex investment structures. The group delivers outsourced operational and fund administration services to more than 500+ clients worldwide representing $870+bn in assets under administration, including fund managers in private equity, venture capital, real estate, private credit, infrastructure and other hard assets. By pairing the industry's premier talent with the most advanced technology, SS&C can deliver a uniquely comprehensive offering that complements our clients' long-term growth. Learn more at ssctech.com

[1] Preqin 2022 Global Private Debt Report
https://www.preqin.com/insights/global-reports/2022-preqin-global-private-debt-report
[2] Thomson, Andy, "Has Asia-Pacific's Growth Engine Stalled?" Private Debt Investor, January 27, 2022
https://www.privatedebtinvestor.com/has-asia-pacifics-growth-engine-stalled/